

FastLane Group

' Together We Build Better Business '

A man and a woman are sitting at a table in a bright, modern office or meeting space. The man, wearing glasses and a checkered shirt, is gesturing with his hands while speaking. The woman, wearing a white top, is listening attentively. A laptop is open on the table, displaying a green screen. A white coffee cup is also on the table. The background shows large windows with a view of greenery.

A Beginner's Guide to **Hong Kong Taxation**

About FastLane

The Fastlane Group was founded in 2013 as an accountancy and advisory firm that combines innovation and technology to expert professional services within the SME market, with a particular focus on Entrepreneurs, Startups, Fast Growing Technology Companies, Startup Angel Investors and Venture Capitalists. The Fastlane Group provides best in class service for businesses wishing to launch and operate in Hong Kong, ensuring they maintain the financial and compliance needs as regulated in Hong Kong.

Offering a diverse range of professional services including accountancy, auditing, company formation and payroll management and HR advisory assistance, the Fastlane Group is able to provide a holistic and comprehensive suite of services for our clients.

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This eBook is available to download as a free PDF at:

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Get in Touch

For more information or to contact FastLane Group on Taxation, please email:

hello@fastlanepro.hk

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The Fastlane Group currently supports over 500 companies and is experiencing rapid growth with business partners and supporting networks.

Our Mission

We strive to establish a secure and rewarding partnership with our customers to enable successful business operations within the SME market in Hong Kong.

We facilitate and introduce our customers to cutting edge technologies across a suite of professional services, allowing the autonomy to build efficient and effective organizations.

We are a business builder, professional advisor and accountant.

Or make a request to hello@fastlanepro.hk to download a copy.

Disclaimer

This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

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1 Basic Introduction to the Tax System in Hong Kong

Figure 1 | Map of Hong Kong

1.0

The Tax System in Hong Kong

The Hong Kong tax system has largely remained the same since 1997 and the Basic Law of Hong Kong ensures that Hong Kong remains independent of the tax system of Mainland of China. In addition, under Article 106 of the Hong Kong Basic Law, Hong Kong enjoys independent public finance, and no tax revenue is handed over to the Central Government in China.

The Hong Kong tax authority continues to effectively raise revenue through a range of taxes, notably; profits tax, salaries tax, property taxes and stamp duty. The administration of Hong Kong taxation is relatively simple, transparent and straightforward among jurisdictions in the world. Taxes are collected through the Inland Revenue Department (IRD).



Principles of Taxation

The principles of taxation in Hong Kong is on a territorial basis. This means that generally, only income arising in or derived from sources in Hong Kong is subject to tax. Capital gains are outside the scope of charge for tax in Hong Kong.

1.1

Profits Tax In Hong Kong**Hong Kong's Two-tiered Profits Tax Regime**

The Inland Revenue Department (IRD) introduced a two-tiered profit tax rate regime on December 29, 2017. With the aim to maintain a simple and low tax regime, as well as promoting economic development, the introduction of the two-tiered profit tax regime intends to reduce the tax burden on enterprises, with a particular focus on SMEs in Hong Kong.

For corporations, the tax rate for the first HK\$2 million of assessable profits will be 8.25%, and the remaining profits will be taxed at the existing 16.5% tax rate.

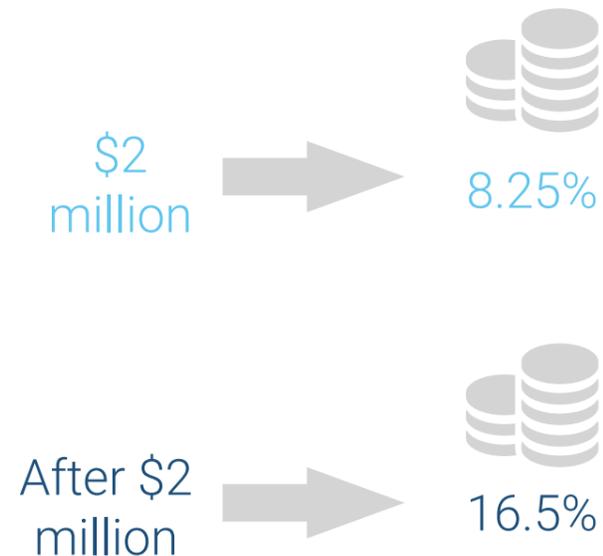


Figure 2 | Tax Rates Applicable to Corporations

Persons Chargeable to Tax

"Person" includes corporation, partnership, trustee, whether incorporated, or body of persons that facilitate trade, profession or business in Hong Kong, are legally required to be subjected to tax on all profits derived from Hong Kong.

Trade, Profession and Business Losses

Tax losses can be carried on indefinitely to offset against future assessable profits on the same trade, profession and business. This applies to individuals, corporations, partnerships and trustees.

Gov HK 2019, Tax Rates of Profits Tax, Gov HK, viewed on April 2019, <gov.hk/en/residents/taxes/taxfiling/taxrates/profitsrates.htm>

2 Types of Tax Returns

2.0

Tax Returns

Under Section 51(1) of the IRD, an assessor may give notice to any person in writing, requesting that the person has to furnish a return that may be specified by the Board of Inland Revenue, within a reasonable time stated in the notice (normally one month).

Two Types of Returns> **Profits Tax Return**

There are three series of Profits Tax return forms:

- Profits Tax Return - Corporations (BIR51)
- Profits Tax Return - Persons Other Than Corporations (BIR52)
- Profits Tax Return - In Respect Of Non-Resident Persons (BIR54)

> **Employer's Return**

This is for the remuneration returns for all employees.

- Employer's Return - (BIR56A) issued on 1 April with 1 month for filing



3 Preparation of the Profits Tax Return

3.0

Profits Tax Return Filing Timeline

For recently a formed company in Hong Kong, the first Profit Tax Return will be provided approximately 18 months after the date of incorporation. A Tax Return (BIR51 or BIR52 or BIR54) is required to be submitted along with an audit report to the IRD within 3 months from the day of issue. Thereafter, Profits Tax Return will be issued by the IRD on the first working day of April every following year.

It is required to complete and file an audit report every year, within 1 month of the date of issue.

	Date of Issue	Deadline for Submission
Initial Profit Tax Return	About 18 months from the date of incorporation	3 months from the day of issue
Profits Tax Return Thereafter	First working day of April every year	1 month from the day of issue



Figure 3 | Photo of Calculating Tax



FastLane can help provide guidance, complete your audit report and prepare your tax computation.

4 Audit and Tax Submission Requirements

4.0

Audit Requirements in Hong Kong

All Hong Kong incorporated companies are statutorily required by the Companies Ordinance to audit their financial statements on a yearly basis.

Financial statements are accounting documents prepared by a Certified Public Accountant (CPA) on behalf of a business, with the aim to provide financial accountability to the company's stakeholders. For private companies, financial statements are not required to file on public record.

For corporate entities, financial statements are required to comply with the disclosure requirements set out in the 'Company Ordinance', 'The Hong Kong Financial Reporting Standards', and 'The Rules of The Stock Exchange of Hong Kong Limited' for listed companies.

To comply with the Hong Kong Companies Ordinance, all companies should have accounting records for:

- > All sums of money received or expended by the company and the matters in respect of which the receipt and expenditure takes place;
- > All sales/service income and direct operating costs of the company;
- > The assets and liabilities of the company.

Accounting records must be kept for seven years from the end of the financial year in which the last entry was made, or to which the last recorded matter relates.

In Hong Kong, only a Certified Public Accountant firm (CPA) can perform the audit and provide an audit opinion of the financial statements. However, it is not the responsibility of a CPA firm to prepare the financial statements. The financial statements can be produced by an in-house accounting team or outsourced to an external professional accounting firm.

* Please Note

For businesses that operate offshore, the relevant supporting invoices and receipts, along with other relevant records, are still required to be kept.



FastLane is a licensed HK CPA firm.

4.1

Preparation of Financial Statements

While an audit must be done by a CPA, accounting can be performed by an in-house employee or external accounting firm who has the relevant accounting knowledge and qualifications. The qualifications and knowledge needed are dependent on the complexity of the business nature and operations.

Financial statements include a Profit and Loss Account, Balance Sheet, Trial Balance and General Ledger. It is advisable to maintain the habit of managing the statements on a monthly basis, especially for those who have a lot of entries and a pile of supporting documents.

It is essential to submit well-organised accounts to the CPA firm. If the financial statements are disorganised and unclear, it may cause a delay in completing the audit (which also means additional charges from the CPA firm).

While accounting may seem to be a tedious job, using cloud-based accounting systems like Xero can help the preparation of the financial statements and manage the company accounts with ease. Designed for SMEs, Xero can run a series of crucial accounting jobs online, such as running a payroll, managing expenses and generating financial reports.

What should be included in the Profits Tax Return?

- Balance Sheet
- Profit & Loss Account
- A tax computation with supporting schedules
- An auditor's report run by a CPA



Figure 4 | We are Xero Certified.



Contact FastLane to start your Xero online accounting journey here!

4.1

In order to prepare for the audit, it is the best practice to have a list of required documents prepared.

Checklist of Required Documents:

- Audited financial statements of subsidiary companies
- Bank statements (The auditor might ask you to sign a confirmation form which will be sent to the bank to obtain the bank balance)
- Copy of original Profit Tax Return from the IRD
- All sales invoices with the corresponding receipt
- All financial statements
- All sales/service agreements, employment contract, tenancy agreement
- All purchase invoice
- Copy of any special license like SFC License and Property Agent License (if any)
- Receipt for all expenses
- Copy of company registration documents:

(Updated business registration certificate, Incorporation certificate, Articles of association, Annual Return)

An audit report is required even if the company has not generated any income. If the company has not yet commenced, it is allowed to report to the IRD as "not yet commenced" by the absence of an audit report. Once the business has been launched, it will be required to submit the first and subsequent years' financial statements to the IRD.

4.2

Year of Assessment

The tax year or year of assessment starts from 1st April to the 31st March of the following year. For profits tax, the assessment is based on the accounting profits of the financial year ending within the year of assessment with appropriate adjustment for tax purposes.

The financial cut-off date for most Hong Kong companies is either December 31st or March 31st.

Deductions

Profits tax is levied based on the assessable profit, excluding deductible expenses and tax-exempt incomes.

While dividends (profits arising from the sale of capital assets and interest on deposits placed in authorised financial institutions) can be exempted from tax, there are other expenses that can be deducted from the assessable profit.

Expenses that are incurred by the taxpayer in the production of chargeable profits are allowed as deductions (Reference to section 16 of the I.R.O.).

Generally speaking, business expenses that relate to your day to day business operations are deductible as your operating expenses, for example:

- > Rent paid on business premises for business premises
- > Light, water and telephone charges for business premises

Double Tax Agreements

Hong Kong has entered comprehensive double tax agreements / arrangements on income with a large number of jurisdictions.

- > Employer's mandatory and voluntary contributions to MPF schemes (Deduction limited to 15% of the total emoluments)
- > MPF mandatory contributions if self-employed (applicable to the sole proprietor or partner)
- > Severance or long service payments at the termination of employment
- > Bad or doubtful debts
- > Repairing costs for premises, machinery and plants used in producing profits
Replacement costs of implements and utensils used in producing profits
- > Donations to approved charities valuing no less than \$100 but not exceeding 35% of the adjusted assessable profits.

4.2

Penalties for Late Submission

The Inland Revenue Department ("IRD") may take punitive actions for failure to file the profits tax return by the due date:

- Prosecution
- Compound Offer
- Additional Tax (which is a form of penalty) in respect of the offence
- Estimated Assessment

Offence

An offence is committed by non-compliance without a reasonable excuse or wilful wrongdoing. Lack of knowledge, incompetent staff, language difficulty and ignorance of law are not reasonable excuses. A committed offence will result in penalties, such as 300% of tax undercharge and fines.

Objection

Taxpayers can lodge an objection to a tax assessment. The notice of objection must be in writing and precisely state the ground for objection. This must be received by the Commissioner within one month after notice assessment. However, there is no deadline placed on the IRD to review and decide on the objection.

Holdover of Tax

The taxation under dispute in an objection, can be held over (not paid) until the dispute is resolved.

5 Simple Offshore Company's Guide to Profits Tax Exemption in Hong Kong

5.0

Hong Kong Offshore Company Tax Exemption

To get the offshore status for companies in Hong Kong, there needs to be proof that the business does not have any presence in Hong Kong, and are not selling to local people or businesses in Hong Kong.

The difference between Hong Kong profits and offshore profits are made by reference to gross profits arising from individual transactions derived out of Hong Kong. This includes business incorporation information, the passports of all company directors, company invoices and other relevant documents. The offshore claim status will stay effective over the course of 3 years.

Here are some examples that would ensure the business qualifies for an offshore profit tax exemption:

- > All the business income is generated outside of Hong Kong;
- > There are no customers (people or business) or suppliers for the business in Hong Kong;
- > The business (including the employees) is operating outside of Hong Kong;
- > The service and products are not available in Hong Kong;
- > The day-to-day business decisions and service agreements are signed outside of Hong Kong.

5.1

Application for Profits Tax Exemption Annually

Even with the offshore company status, yearly audits on the accounts and submission of documents with the profit tax return to IRD are required.

When submitting the profit tax return, a certified copy of the Financial Statement along with Profit and Loss Account, the tax computation and the offshore tax exemption application will need to be provided.

To examine the offshore claim, the IRD may review the transactions to investigate whether the offshore claim is valid. Therefore, it is recommended to keep the complete transaction records, service agreements, meeting summaries, travel receipts, purchasing receipt, shipping documents and other business related documentation ready.

6 Other Frequently Asked Questions

6.0

What exactly happens during an audit?

- > The company prepare **the financial accounts along with the supporting documents** or the CPA's further handling.
- > The auditor reviews and understands the activities of the company as well as the nature of the company, that could affect the audit.
- > The auditor identifies and evaluates significant transactions in the financial statement.
- > The auditor tests the financial statements, spots uncertainties and errors that could influence the financial accounts.
- > The auditor reviews the financial statements and its supporting documents to ensure that the report on transactions is accurate.
- > The auditor creates an opinion report to reflect the accuracy and fair representation of the company's financial statements.

- > The auditor makes a report from the audit and opinion on the financial statements.
- > The director of the company signs the audit report and the supporting documents.
- > The auditor receives the signed audit report and creates a tax computation form and sends this back to the IRD along with the Profits Tax Return.

The content and depth of the audit documents depend on the identified risks of material misstatement, the judgement required in performing the audit and the significance of the audit evidence obtained by the auditor.

How can I apply for reporting exemption?

According to the new Company Ordinance, private and guarantee companies are qualified to prepare simplified accounts and directors' reports.

To be qualified for the reporting exemption, you need to meet the requirements on the next page.

6.0

How can I apply for reporting exemption?

For a small private company, it is required to meet two of the following conditions:

- > Your total revenue does not exceed \$100 million in a financial year;
- > Your total assets does not exceed \$100 million in a fiscal year;
- > The number of employees does not exceed 100 people in a financial year.

For a small guarantee company, it is required that:

- > Your total revenue does not exceed \$25 million in a fiscal year.

* Please Note

that for the subsidiaries of a listed company, you may qualify for reporting exemption, in the case that it is not a company specified in section 359(4) (for example, an insurance company or a bank) if you meet the requirements above.

How does reporting exemption help simplify the reports for qualified companies?

For companies that qualify for reporting exemption, the financial statements can be prepared following the Small and Medium-Sized Entity Financial Reporting Standard and Financial Reporting Framework.

Moreover, for the qualified companies, it is not required to prepare the following when creating the accounts and directors' reports:

- > Disclosure of the auditor's remuneration in financial statements;
- > A "true and fair view" for financial statements;
- > Disclosure in the material interests of directors in transactions or contracts within the notes to financial statements;
- > The inclusion of the following information in the director's report:
 - Business review
 - Donations
 - Director's reason for resignation
 - Material interests of directors in transactions, arrangements and contracts

* Please Note

that for reporting exemption-qualified companies, they are still required to have their financial statements audited.

6.0

When is the profit tax return deadline for 2019?

The due date for profit tax return depends on how you set your financial year-end date. For limited companies or unincorporated businesses in Hong Kong, you can select any date as your fiscal year-end date. Most companies in Hong Kong set their financial year-end date on December 31st or March 31st.

It is worth mentioning that for new companies in Hong Kong, the first profit tax return will be sent to you by the IRD (Inland Revenue Department) 18 months after the date of incorporation, and you will have a 3-month period to return the form. However, starting from the second profit tax return, you will only have 1 month to finish the profit tax return submission.

If you chose December 31st as your financial year-end date, you are required to file your profit tax return by mid-August. For companies that set the fiscal year-end date as March 31, the deadline tax return submission would be mid-November. If you choose a different date as accounting year-end date, IRD will send you the profit tax return on the first working day of April, and you need to file the tax return by end of April.

What happens if I missed the deadline for profit tax return submission?

Late submission in profit tax return may subject to a penalty payment of HK\$10,000 and triple amount of the tax. You are also subject to prosecution. To avoid delay in profit tax return filing, it is recommended to have **all the documents prepared** for your CPA, as the document preparation process is normally the longest process to an audit.

Can I extend the deadline for profit tax return submission?

Yes, a further 2-weeks extension will be granted to Small Corporations and Small Partnership Businesses on application, if they file the profit tax returns through online platform.

Can I change year-end date for my company?

Yes, you can change the year-end date. However, please note that the financial year cannot be longer than 18 months. It is not allowed to extend the financial year-end date again within a five-year period from your previous year-end extension.



Contact FastLane if you have any further tax related questions.

6.0

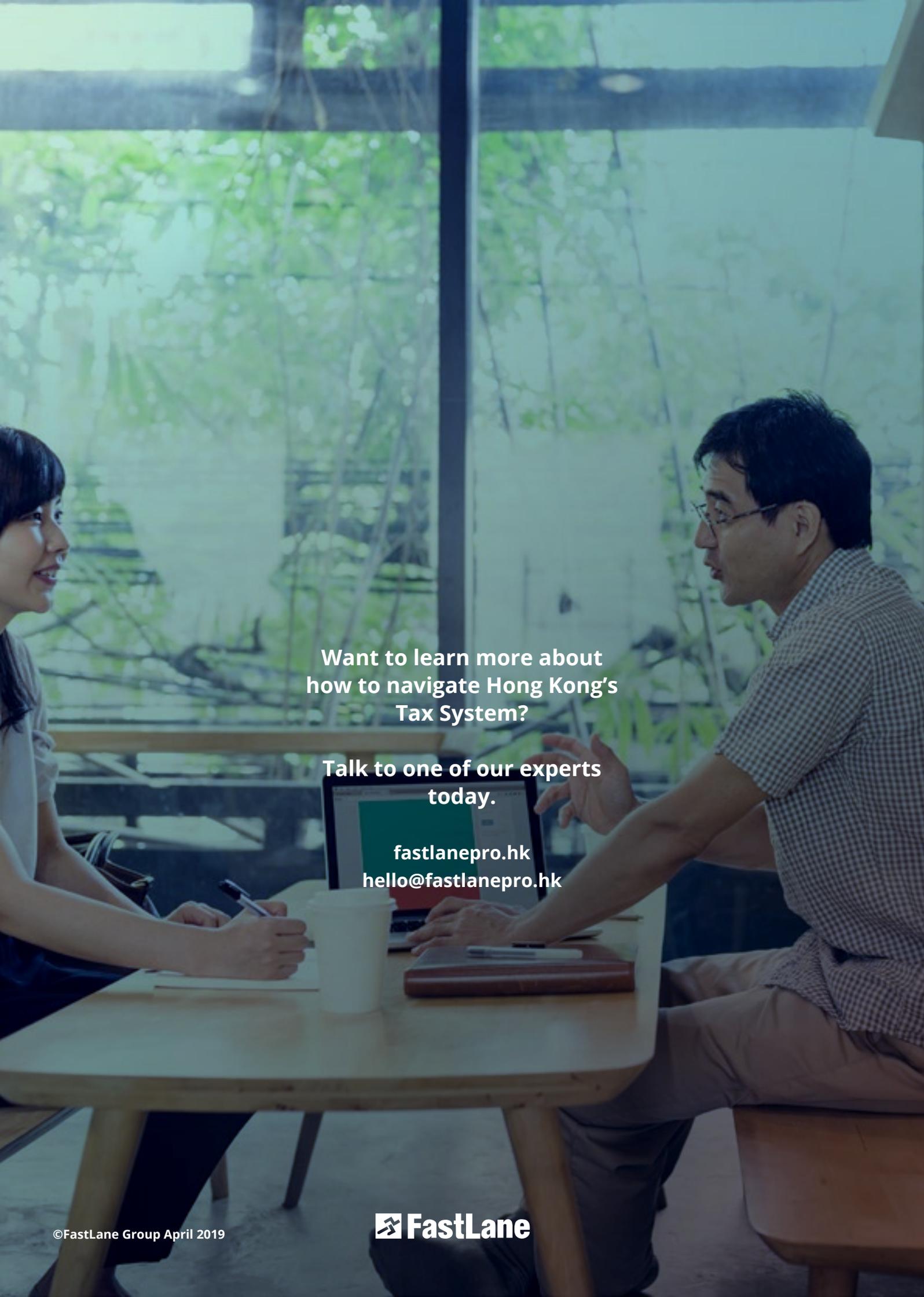
Do I still need to audit my accounts and submit profit tax return if I am not making profits or the business has not yet started?

In the case that your business has yet to commence, you are allowed to report that it has "not yet commenced" to IRD (Inland Revenue Department). The company director or company secretary must provide a declaration of not yet commenced business. You can file a "NIL" profit tax return to the IRD by absence of an audit report.

However, please note that it is still required to prepare an audited financial statement even when the business has not yet started. Once your business commences, you are required to submit your first and subsequent years' financial statements.



Figure 5 | Photo of Calculating Tax



Want to learn more about
how to navigate Hong Kong's
Tax System?

Talk to one of our experts
today.

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